

Message Text

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ACTION ABF-01

INFO OCT-01 EA-11 ISO-00 A-01 TRSE-00 OPR-02 FS-01 AID-20

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FM AMEMBASSY PHNOM PENH

TO SECSTATE WASHDC PRIORITY 6870

N O N F I D E N T I A L SECTION 1 OF 2 PHNOM PENH 9294

E.O. 11652: GDS

TAGS: EFIN, CB

SUBJ: PREFERENTIAL RATE OF EXCHANGE

REF: STATE 138844

1. WE APPRECIATE YOUR GUIDANCE PER REFTTEL ON THE INFORMATION REQUIRED BY TREASURY TO GET A PREFERENTIAL EXCHANGE RATE FOR OFFICIAL U.S. EXPENDITURES AND PERSONAL ACCOMMODATION.

2. AS ILLUSTRATED IN THE ANALYSIS BELOW, U.S. GOVERNMENT WOULD HAVE SAVED AN ESTIMATED \$420 THOUSAND IN OFFICIAL DISBURSEMENTS IF A REALISTIC (PREFERENTIAL) RATE HAD BEEN APPLIED TO THESE TRANSACTIONS IN FY 1974, AND MIGHT SAVE AN ESTIMATED ADDITIONAL \$600 THOUSAND IN FY 1975 IF A REALISTIC PREFERENTIAL RATE POLICY IS ESTABLISHED. SIMILARY, U.S. PERSONNEL SERVING IN CAMBODIA WHO MUST CONVERT THEIR DOLLARS TO RIELS TO FINANCE LOCAL LIVING EXPENSES, WOULD HAVE SAVED AN ESTIMATED \$460 THOUSAND IN FY 1974, AND COULD BE SAVED AN ESTIMATED \$1.2 MILLION IN FY 1975 IF ALLOWED CONVERT AT A FAIRLY REALISTIC RATE.

3. IN FY 1974, RIEL EXPENDITURES FOR OFFICIAL USES (E.G., LOCAL SALARIES, RENT, SUPPLIES, AND MAINTENANCE COSTS) TOTALLED 454.4 MILLION, EQUIVALENT TO \$1.33 MILLION AT THE ACTUAL AVERAGE TRANSACTIONS RATE OF 340 RIELS PER DOLLAR. A MORE REALISTIC AVERAGE RATE OF

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EXCHANGE FOR SUCH TRANSACTIONS DURING FY 1974, TAKING

MARKET TRENDS INTO ACCOUNT, WOULD HAVE BEEN AROUND 500 RIELS PER DOLLAR, WHICH CORRESPONDS ROUGHLY TO THE MEAN FREE MARKET RATE FOR THE YEAR. HAD OFFICIAL TRANSACTIONS TAKEN PLACE AT THE MORE REALISTIC 500 RATE, U.S. EXPENDITURES WOULD HAVE BEEN ONLY \$910 THOUSAND (DOLLAR EQUIVALENT) OR \$420 THOUSAND LESS THAN THE \$1.33 MILLION ACTUALLY SPENT. FOR FY 1975, IT IS EXPECTED THAT DUE TO RISING COSTS AND INFLATION, U.S. RIEL EXPENDITURES FOR OFFICIAL USES WILL TOTAL SOME 908 MILLION OR ROUGHLY DOUBLE THE RIEL VALUE OF EXPENDITURES IN FY 1974. THE AVERAGE EXCHANGE RATE FOR OFFICIAL TRANSACTIONS IN FY 1975 IS PROJECTED AT 600 RIELS PER DOLLAR, A MODEST 76 PERCENT HIGHER THAN THE ACTUAL 340 RATE WHICH PREVAILED IN FY 1974. GKR RELUCTANCE TO DEVALUE FOR POLITICAL REASONS IS THE CHIEF REASON FOR SUCH A CONSERVATIVE ESTIMATE. AT THIS 600 RATE, THE DOLLAR EQUIVALENT OF U.S. OFFICIAL TRANSACTIONS WOULD BE APPROXIMATELY \$1.51 MILLION. AGAIN, IF THIS VOLUME OF TRANSACTIONS WERE TO OCCUR AT A HIGHER AVERAGE RATE OF, SAY, 1,000 RIELS PER DOLLAR (WHICH COMPARES WITH A FY BEGINNING FREE MARKET RATE OF 1,300), THEN DOLLAR EQUIVALENT EXPENDITURES WOULD NEED TO BE ONLY \$908,000 (908 MILLION DIVIDED BY 1,000 RIELS PER DOLLAR), FOR A POTENTIAL SAVINGS OF \$600 THOUSAND.

4. PERSONAL PURCHASES OF RIELS FOR DOLLARS IN FY 1974 ARE ESTIMATED TO HAVE AMOUNTED TO APPROXIMATELY \$400 PER PERSON PER MONTH. IN ADDITION TO THE 200 U.S. GOVERNMENT PERSONNEL WHO USED THE USDO FACILITY FOR CURRENCY EXCHANGE, IT IS ESTIMATED ABOUT 100 OTHERS ALSO USED IT (VOLAGS, VINNELL, AIR AMERICAN, ETC.). ALL TOLD, PERSONAL ACCOMMODATIONS TRANSACTIONS IN FY 1974 TOTALLED ROUGHLY \$120,000 MONTHLY OR \$1.44 MILLION ANNUALLY. AT THE 340 AVERAGE FY 1974 TRANSACTIONS RATE, THE APPROXIMATE VALUE OF PERSONAL LOCAL PURCHASES IN RIEL TERMS WAS 490 MILLION. HAD THESE TRANSACTIONS OCCURRED AT THE MORE REALISTIC 500 RATE IN FY 1974, PERSONAL DOLLAR EXPENDITURES WOULD HAVE BEEN ONLY \$980 THOUSAND OR SOME \$460 THOUSAND LESS THAN THE ACTUAL VALUE, A POTENTIAL SAVINGS OF OVER \$1,500 PER PERSON. ASSUMING PERSONAL REQUIREMENTS FOR RIELS ROUGHLY DOUBLE IN FY 1975 (AS IN THE CASE OF OFFICIAL EXPENDITURES),
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U.S. PERSONNEL ASSIGNED TO SERVICE IN CAMBODIA WILL LOSE EVEN MORE IN CONVERTING THEIR DOLLARS TO RIELS. WE ESTIMATE PERSONAL RIEL EXPENDITURES AT 980 MILLION RIELS 490 MILLION ESTIMATED FOR FY 1974 TIMES 2). AT THE ASSUMED AVERAGE FY 1975 TRANSACTIONS RATE OF 600 RIELS PER DOLLAR, THESE LOCAL FUNDS WILL COST AMERICANS ROUGHLY \$1.6 MILLION. AT THE PROJECTED HIGHER, AND MORE REALISTIC AVERAGE TRANSACTIONS RATE OF 1,000 RIELS PER DOLLAR, THE COST WOULD BE

ONLY \$980,000 OR APPROXIMATELY \$620,000 LESS.
THIS WOULD AMOUNT TO OVER \$2,000 PER PERSON.

5. THESE IMMEDIATE DOLLAR SAVINGS TO THE U.S. GOVERNMENT AND TO U.S. PERSONNEL SERVING IN PHNOM PENH, WOULD OF COURSE BE OFFSET BY A REDUCTION IN THE AMOUNT OF U.S.-OWNED LOCAL CURRENCY FUNDS AVAILABLE FOR FUTURE USES, BUT THE AMOUNT OF SUCH U.S.- OWNED LOCAL FUNDS PRESENTLY CONSTITUTES A 21-YEAR PIPELINE AND WE DO NOT SEE ANY PARTICULAR ADVANTAGE TO FOREGOING AN IMMEDIATE DOLLAR SAVING IN ORDER TO PRESERVE A POTENTIAL FUTURE ONE. MOREOVER, IT SHOULD BE NOTED THAT OUR PRESENT 21-YEAR ESTIMATE OF THE PIPELINE OF LOCAL FUNDS RESERVED FOR FUTURE U.S. USES IS BASED ONLY ON GENERATIONS FROM PL 480 AGREEMENTS SIGNED THROUGH FY 1974. IN ADDITION TO PRESENT AVAILABILITIES, FAIRLY SUBSTANTIAL AMOUNTS OF ADDITIONAL FUNDS ARE EXPECTED TO BE FORTHCOMING FROM PL 480 PROGRAMS OVER THE NEXT TWO TO THREE YEARS AND THESE ADDITIONAL FUNDS COULD WELL EXTEND THE PIPELINE EVEN FURTHER INTO THE FUTURE, BY SOME 10 TO 15 YEARS.

6. PERHAPS WE HAVE NOT ADEQUATELY CONVEYED IN OUR EARLIER CABLES THE EXTENT TO WHICH THE RIEL IS PRESENTLY OVERVALUED.

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ACTION ABF-01

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P 120820Z JUL 74

FM AMEMBASSY PHNOM PENH

TO SECSTATE WASHDC PRIORITY 6871

C O N F I D E N T I A L SECTION 2 OF 2 PHNOM PENH 9294

THE EXTENT OF OVERVALUATION IS VERY SIGNIFICANT BECAUSE U.S. OFFICIAL EXPENDITURES AND PERSONAL OUTLAYS HERE ARE ACTUALLY TAKING PLACE AT RATES MUCH CLOSER TO THE FREE MARKET EXCHANGE RATE, THAN THE OFFICIAL RATE. THERE HAS BEEN A STEADILY WIDENING DIVERGENCE BETWEEN THE FREE MARKET RATE OVER THE PAST YEAR AND A HALF, AND THIS TREND HAS

ACCELERATED DRAMATICALLY IN THE PAST THREE MONTHS. THE FOLLOWING TABLE PERTAINS:

ACTUAL

	OFFICIAL	FREE MKT		DOLLAR
DATE	RATE	RATE	PREMIUM (PCT)	VALUE
12/31/72	187	235	26	.80
12/31/73	302	420	59	.63
3/31/74	377	640	70	.59
6/30/74	420	1010	140	.42
7/10/74	420	1300	210	.32

THE INCREASING OVERVALUATION OF THE RIEL IS ALSO CLEARLY EVIDENT FROM RECENT MOVEMENTS OF THE BIDDING RATE FOR IMPORT EXCHANGE FUNDS ON THE NOUVEAU MARCHE DES CHANGES (NMC). IN LATE APRIL 1974, WHEN THE OFFICIAL RATE WAS MOVED FROM 377 RIELS PER DOLLAR TO 420, THE AVERAGE BIDDING RATE ON THE NMC WAS AROUND 480 ON BOTH A NUMBER AND VALUE OF TRANSACTIONS BASIS. BY EARLY JULY, THE AVERAGE BIDDING RATE HAD MOVED UPWARD TO 590, WHILE THERE HAS BEEN NO CHANGE IN THE OFFICIAL RATE, WHICH IS THE RATE AT WHICH NMC TRANSACTIONS ACTUALLY TAKE PLACE. FURTHER INDICATION OF RIEL OVERVALUATION IS THE FACT THAT THE RIEL-DOLLAR RATE IN HONG KONG DETERIORATED FROM 503 RIELS PER DOLLAR FOR THE

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FIRST WEEK IN JUNE TO 719 RIELS PER DOLLAR BY THE LAST WEEK IN JUNE. BANGKOK HAS REPORTED THAT NEITHER BANKS NOR MONEY CHANGERS THERE WILL PRESENTLY DEAL IN RIELS.

7. GIVEN THE OVERWHELMING EVIDENCE AVAILABLE INDICATING CONSIDERABLE AND INCREASING OVERVALUATION OF THE RIEL AND CONSEQUENT UNDERVALUATION OF THE DOLLAR, IT SEEMS COMPELLING THAT SOME IMMEDIATE ADJUSTMENT BE MADE TO RELIEVE THE FINANCIAL BURDEN ON THE MISSION AND PERSONNEL STATIONED HERE. FROM THE STANDPOINT OF ECONOMIC POLICY, WE RECOGNIZE THAT IT WOULD BE MORE ADVANTAGEOUS TO BRING ABOUT AN UPWARD SHIFT IN THE OFFICIAL RATE OF EXCHANGE THROUGH DEVALUATION OF THE RIEL SINCE THIS WOULD HELP AVOID A PROLIFERATION OF EXCHANGE RATES AND SIMPLIFY EXCHANGE POLICIES. AS WASHINGTON IS AWARE, WE HAVE AND ARE CONTINUING STRENUOUS EFFORTS TO BRING THIS ABOUT. THIS WAS ALSO ONE OF THE PURSUITS OF THE IMF TEAM THAT VISITED WITH GKR FINANCIAL OFFICIALS IN BANGKOK RECENTLY. HOWEVER, THE LIKELY POLITICAL REPERCUSSIONS THAT WOULD ENSUE, IN OUR JUDGEMENT, PRECLUDE RIEL DEVALUATION AS A PRACTICABLE STEP FOR THE PRESENT. THE ONLY FEASIBLE ALTERNATIVE, WHICH WOULD NOT HAVE ANY APPRECIABLE IMPACT ON THE DOMESTIC POLITICAL SITUATION IS A PREFERENTIAL RATE FOR U.S. GOVERNMENT TRANSACTIONS. AS REPORTED EARLIER, WE KNOW THIS PRACTICE IS AND HAS BEEN DONE IN OTHER COUNTRIES. WE DO NOT UNDERSTAND WHY IT CANNOT BE DONE IN CAMBODIA.

8. IN SUMMARY, THE INSTITUTION OF A PREFERENTIAL RATE WOULD RESULT IN IMMEDIATE BUDGETARY SAVINGS TO THE U.S. GOVERNMENT OF AT LEAST \$600 THOUSAND IN FY 1975, DEPENDING UPON THE LEVEL OF THE PREFERENTIAL RATE ESTABLISHED AND THE CORRESPONDING MOVEMENT OF THE OFFICIAL RATE. WE HAVE SHOWN THESE TWO RATES IN THE ABOVE ANALYSIS AT 1,000 AND 600 RIELS PER DOLLAR RESPECTIVELY. ON THE BASIS OF CURRENT TRENDS (SPECIFICALLY THE PRESENT 1,300 RIEL PER DOLLAR FREE MARKET RATE), THE PROJECTED PREFERENTIAL RATE SHOULD BE VIEWED AS "MINIMALLY REALISTIC", ALL THINGS CONSIDERED.

9. THE SAVINGS THAT WOULD ACCRUE TO U.S. PERSONNEL SERVING IN CAMBODIA ARE OBVIOUS. WHILE WE HAVE CALCULATED THESE BENEFITS ABOVE IN DOLLAR TERMS, POTENTIAL VALUE IN MORALE TERMS HERE IS INESTIMABLE.

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10. WE APPRECIATE YOUR CONTINUED SUPPORT AND LOOK FORWARD TO AN EARLY, FAVORABLE RESPONSE.
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